Supreme Court, U.S.
FILED
DEC 28 1992

No. 92-913

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

BANCO ESPANOL DE CREDITO, BANESTO BANKING CORPORATION, BANCO TOTTA & ACORES, GIROZENTRALE UND BANK DER OSTERREICHISCHEN SPARKASSEN AG, HARMONY GOLD LTD. HONG KONG, INTERNATIONAL COMMERCIAL BANK OF CHINA, MONROE BANK & TRUST, PHELPS DODGE CORPORATION, and STATE STREET BANK & TRUST COMPANY, as Master Trustee for the Retirement Plans of Atlantic Richfield Company and certain of its subsidiaries,

Petitioners,

—against—

SECURITY PACIFIC NATIONAL BANK and SECURITY PACIFIC MERCHANT BANK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Second Circuit correctly applied the test of *Reves v. Ernst & Young*, 494 U.S. 56 (1990), to respondents' loan participation program when it held, as have all seven circuit courts of appeals that have addressed the issue, that loan participations are not "securities" under the federal securities laws?

List of Parties and Rule 29.1 Statement

Petitioners' List of Parties fails to note the participation of the New York Clearing House Association, an association of leading commercial banks, as *amicus curiae* in the proceedings below.

Security Pacific National Bank was merged into Bank of America NT&SA on April 21, 1992. Its parent is BankAmerica Corporation. Its subsidiaries (except wholly-owned subsidiares) are:

693327 Ontario Limited
Film Asset Holding Company
NDC Securities Limited
Pacific Economic Revitalization Corporation

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BANCO ESPANOL DE CREDITO, BANESTO BANKING CORPORATION, BANCO TOTTA & ACORES, GIROZENTRALE UND BANK DER OSTERREICHISCHEN SPARKASSEN AG, HARMONY GOLD LTD. HONG KONG, INTERNATIONAL COMMERCIAL BANK OF CHINA, MONROE BANK & TRUST, PHELPS DODGE CORPORATION, and STATE STREET BANK & TRUST COMPANY, as Master Trustee for the Retirement Plans of Atlantic Richfield Company and certain of its subsidiaries,

Petitioners,

—against—

SECURITY PACIFIC NATIONAL BANK and SECURITY PACIFIC MERCHANT BANK,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents Security Pacific National Bank and Security Pacific Merchant Bank (collectively "Security Pacific") respectfully submit this brief in opposition to the Petition for a Writ of Certiorari ("Pet.") filed by petitioners on November 25, 1992, which seeks to overturn the judgment of the United

States Court of Appeals for the Second Circuit entered on June 24, 1992, as amended on September 8, 1992. The opinion of the Court of Appeals is now reported at 973 F.2d 51 (2d Cir. 1992). The opinion of the District Court that the Court of Appeals affirmed is reported at 763 F. Supp. 36 (S.D.N.Y. 1991).

COUNTER-STATEMENT OF THE CASE

Petitioners "concede that traditional loan participations do not qualify as securities" under any test. Pet. App. 8a.[1] Nothing in the Second Circuit's careful and narrow application of that settled principle to the particularities of Security Pacific's loan participation program merits this Court's granting of the writ.

Loan participations, as defined under federal banking law, are arrangements in which a bank makes a loan to a borrower and then sells all or a portion of that loan to a purchasing bank or institution. Pet. App. 50a. Succinctly put by the Court of Appeals, it is "[t]he practice of selling loans to other institutions." Pet. App. 5a. Commercial banks have participated loans to banks and non-banks alike since before the turn of the century. The sale of participations helps originating banks to diversify and reduce credit risks, and increases overall credit availability while enabling originating banks to comply with regulatory requirements relating to capital rates. Pet. App. 5a, 9a, 35a; *see also* NYCH Br. 1, 2.

Because participants cannot unilaterally re-sell the loans to third parties, there is no "market" for loan participations. Pet. App. 22a. Rather, the business of participating loans remains limited to large originating banks and large institutional participants, who hold the loans for their duration. Pet. App. 5a, 9a, 29a. While in recent years the business has evolved toward shorter-term loans (sometimes called "loan notes"), its essen-

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1 References to the Appendix to the Petition for a Writ of Certiorari are herein cited as "Pet. App. ____a". References to the Joint Appendix filed by the parties in the United States Court of Appeals for the Second Circuit are herein cited as "A ____". References to the brief of the New York Clearing House Association are herein cited as "NYCH Br. ____".

tials remain unchanged, and it has continued to operate effectively and efficiently, free of any "crisis" or "scandal." *See* NYCH Br. 1, 2.

Since only commercial banks originate loan participations, their regulation vests with state and federal banking authorities, which have promulgated specific requirements governing their sale. Pet. App. 48a-54a. By contrast, the Securities and Exchange Commission ("SEC") has never promulgated a single regulation or ruling addressed to loan participations. In recent years, moreover, the federal courts of appeals have repeatedly and unanimously reaffirmed the principle that loan participations are not securities. Pet. App. 33a.

Against this background, Security Pacific developed in 1985 a loan participation program to service the short-term cash-flow needs of its largest borrowers. Pet. App. 9a, 26a. The bank's loan officers, after full credit reviews, determined and approved both that portion of a borrower's credit needs that could be directly handled by Security Pacific and that portion that was appropriately participated to other lenders so as to diversify risk and avoid exceeding internal lending limits. Pet. App. 5a, 9a, 30a.[2] While there were separate lines of credit for each portion, one line to be held by the lender (Security Pacific) and the other to be promptly sold to participants (Pet. App. 8a, 30a), Security Pacific only participated loans for borrowers that also had non-participated loans with the bank or (in rare cases) that it believed were about to open such non-participated loans.[3]

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2 *See also* A275, A599-600, A627, A3815. Petitioners' claim that "no loan or credit personnel are involved in loan note transactions" (Pet. 7) is entirely mistaken. As stipulated in the parties' Joint Statement of Undisputed Facts (A594-619) at ¶¶ 10-11, Security Pacific's loan officers created and approved each and every participation line-of-credit. A599-600; *see also* A1518-21. Moreover, it was the loan officers who regularly reviewed those lines to assure their creditworthiness. Joint Statement of Undisputed Facts at ¶ 12, A600; *see also* A994, A997-98.

3 Joint Statement of Undisputed Facts ¶¶ 2, 5, A595-96, A598; *see also* A275. Thus, petitioners' claim (Pet. 7) that the bank acted like an "underwriter" because it transferred the "entire credit risk" of the participated loans ignores the economic reality of the overall relationship.

Once loan officers had approved the participation lines, other bank employees undertook to sell each individual loan, in its entirety or in pieces. Pet. App. 26a, 27a.[4] The sales were limited to banks (constituting about half of the participants) and other large and sophisticated institutions that had previously expressed interest in participating in the program. Pet. App. 5a, 9a.[5] Whether they bought the entirety of the participated loan or only a portion, the participants obtained a simple fixed-interest return in a specific, identifiable loan payable at the maturity of the loan. Put another way, the participation had no characteristics different from the underlying loan. Pet. App. 7a-8a, 34a.

The sales, in minimum amounts of $1 million, were made pursuant to a contract, the Master Participation Agreement ("MPA"), that among other things required the participants, in accordance with prevailing banking regulations, to warrant that they had done an independent credit analysis of the borrower before purchasing the loan and that barred them from unilaterally subdividing, transferring or re-selling the loan to any third party. Pet. App. 5a, 28a-30a. The participations, moreover, were non-recourse, so that the participants could look only to the borrower for repayment. Pet. App. 5a. For its part, Security Pacific undertook to manage the loan through its duration, and for this service received a fee consisting of a negotiated percentage that Security Pacific subtracted from the amount remitted to the participant when the loan was ultimately repaid. Pet. App. 5a, 30a.[6]

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4 Contrary to petitioners' claim (Pet. 5), the bank employees who sold loans to participants were not referred to as "traders." Joint Statement of Undisputed Facts ¶ 8, A598.

5 *See also* A629-30. Contrary to petitioners' implications (Pet. 5, 18), Security Pacific never used mass mailings, media advertisements or any other form of public solicitation to attract loan participants. A630. Rather, potential participants were identified from current banking customers and sophisticated money managers of large institutions. A1720-21, A3872-73.

6 *See also* A136-38, A598. Petitioners materially misstate the manner in which the sales took place. Pet. 5. The undisputed evidence shows that before any institution was accepted as a participant in Security Pacific's

One of the borrowers participating in Security Pacific's program was Integrated Resources, Inc. ("Integrated"), a long-standing customer of the bank. Pet. App. 26a, 29a. Integrated was a diversified public company required to file quarterly public reports of all material financial information.[7] In 1988, in response to Integrated's need for short-term loans to meet the cash-flow requirements of its current operations, Security Pacific added a participation line-of-credit to Integrated's other existing lines and notified participants that these loans were now available for purchase. Pet. App. 4a-5a. Over the following year, several of the plaintiffs here—consisting of eight commercial banks, two corporations, and a large corporate pension trust—purchased participations in Integrated's short-term loans and were repaid in full. Pet. App. 26a; A425-84. In each such case, they warranted, pursuant to the MPA, that they understood that what they were purchasing was a non-recourse loan to Integrated, that they had done their own independent analysis of Integrated's creditworthiness, and that they were not relying on Security Pacific for any aspect of that determination. Pet. App. 5a, 27a-29a, 42a.

In the Spring of 1989, Security Pacific originated twelve more short-term loans to Integrated and sold them to the plain-

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program, its managerial employees—often including its inside counsel—were made fully familiar with the requirements of the program, agreed to execute the MPA (terms of which were sometimes negotiated) and received a list of participating borrowers (almost all of which were public companies) with ample time to determine their creditworthiness. A600, A784-86, A1036-37, A1078-79, A1382-83, A1417-20, A1447. If the final sales of individual loans thus occupied only "minutes" (Pet. 5), it was because there was nothing left to do but negotiate the price. Nor, despite petitioners' claims (Pet. 6-7), is this any different from the situation with "traditional" loan participations, which historically were sold rapidly to dozens of participating banks that had less access to the borrowers' financial information than was the case here. *See* K. Ahlburg, *The Status of Note Participations Under the Federal Securities Acts*, 8 Harv. J.L. & Pub. Pol'y 465, 467 (1985); S. Stern, *Structuring Commercial Loan Agreements* ¶ 11.11 [4] at 11-32 (2d ed. 1990).

7 *See* A259-67, A272-73, A487-96. In addition, Integrated (like all the bank's borrowers) was subject to yearly credit reviews of all of its lines of credit, including its participation lines. Pet. App. 30a; A600.

tiffs here, eight in their entirety and the other four in pieces. A750-51. In early June, however, Integrated's commercial paper dealer Drexel Burnham Lambert, Inc. (increasingly beset by problems of its own) refused to "roll" some of Integrated's commercial paper that was coming due—thereby precipitating Integrated's default on all its outstanding loans and obligations. Pet. App. 5a.[8]

After some delay, petitioners then brought this action, seeking to renege on their contractual obligations by claiming, for the first time, that the loans extended by Security Pacific to Integrated were actually "securities" subject to the strict rescission provisions of Section 12(2) of the Securities Act of 1933 (the "1933 Act"). 15 U.S.C. § 77*l*(2).[9] In order to repudiate the express terms of the MPA, petitioners thereby sought to impose on the loan participation business a vast regime of securities law requirements wholly foreign to its origin or operation.

Following six months of intensive discovery (including 38 depositions and voluminous document production), the District Court (Milton Pollack, J.) awarded summary judgment to Security Pacific. On the basis of its personal exhaustive review of the record, the District Court held, *inter alia*, that the petitioners knowingly chose:

> to assume the risks and to act on their own responsibility by purchasing without recourse to Security Pacific. The holder of the participation became the lender in fact, with Security Pacific as its collection agent. That was their contractual bargain and expectancy. . . . The participating purchasers did not purchase a security and there is no evidence that they intended to do so. Pet. App. 42a.

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8 *See also* A1265, A1493-96. Security Pacific, which had numerous non-participated lines of credit to Integrated, suffered a loss of $19 million, higher than that suffered by any petitioner. A2587-88.

9 Contrary to petitioners' suggestion (Pet. 10-11), Section 12(2) is not an antifraud statute in the sense of Section 17(a) of the 1933 Act or Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"). At no time did petitioners charge Security Pacific with any intentional fraud or knowing misstatement. Pet. App. 42a.

Finding, further, that the banking industry at large had "universally acted upon the assumption that federal securities law is not applicable to such transactions and this case gives no indication that it should be otherwise" (Pet. App. 42a), Judge Pollack held that these loan participations did not constitute "securities" under any of the conceivably applicable tests. Pet. App. 31a-39a.

On appeal, the Second Circuit, after soliciting the views of the SEC,[10] affirmed "Judge Pollack's well-reasoned opinion." Pet. App. 10a. Applying the four-factor test set forth in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), the Court of Appeals (Altimari, J. joined by Feinberg J., with Oakes, C.J. dissenting) concluded, as had Judge Pollack, that the loan participations sold by Security Pacific to the petitioners were:

> analogous to the enumerated category of loans issued by banks for commercial purposes and therefore do not satisfy the statutory definition of 'notes' which are 'securities'. Pet. App. 10a.

Petitioners filed for rehearing and/or rehearing *in banc*, and these petitions were denied. Thereafter, the court, apparently to clarify that it was not addressing such hypothetical cases as participations in pooled loans or participations offered for resale, briefly amended its opinion to emphasize that:

> We rule only with respect to the loan participations as marketed in this case. We recognize that even if an underlying instrument is not a security, the manner in which participations in that instrument are used, pooled, or marketed might establish that such participations are securities. Pet. App. 23a (citation omitted).

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10 In its brief, the SEC conceded that it had no prior experience with the loan participation business and no specific ruling or regulation pertaining to that business. In the absence of such prior regulations or rulings, its views are entitled to no particular deference. *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 565 (1979); *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977).

While former Chief Judge Oakes—upon whose original dissent petitioners rely heavily—again dissented, he noted that these clarifications "do a lot to narrow the scope and, hence, the impact of [the court's] decision." Pet. App. 23a.

REASONS FOR DENYING THE WRIT

1. This case represents the application of settled law to particular facts that both the District Court and the Court of Appeals found were not genuinely in dispute. Prior to this case, all six other circuits to consider the question had unanimously agreed that loan participations are not securities. *First Citizens Fed. Sav. & Loan Ass'n v. Worthen Bank & Trust Co.*, 919 F.2d 510, 515 (9th Cir. 1990); *McVay v. Western Plains Serv. Corp.* 823 F.2d 1395, 1398-1400 (10th Cir. 1987); *Union Nat'l Bank v. Farmers Bank*, 786 F.2d 881, 884-85 (8th Cir. 1986); *Kansas State Bank v. Citizens Bank*, 737 F.2d 1490, 1493-95 (8th Cir. 1984); *Union Planters Nat'l Bank v. Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1180-85 (6th Cir.), *cert. denied*, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co. v. U.S. Steel Credit Corp.*, 635 F.2d 1247, 1253-55 (7th Cir. 1980), *cert. denied*, 451 U.S. 911 (1981); *United Am. Bank v. Gunter*, 620 F.2d 1108, 1115-19 (5th Cir. 1980). These cases involved a wide range of factual scenarios and application of several different legal tests—but always with the same result.

In the instant case, the Second Circuit applied the test of *Reves* (newly formulated but derived from Second Circuit precedents) to still another factual variation and, not surprisingly, reached the identical result. In so doing, moreover, the Court of Appeals was careful to emphasize the narrow and limited scope of its ruling so as not to forego further analysis of future developments in loan participation programs. In this posture, it is difficult to see any basis for granting certiorari.

Petitioners nonetheless claim that the writ should be granted for two reasons. First, they assert that the Second Circuit's decision "leaves a giant and growing sector of the securities market completely outside the antifraud protections of the

securities laws." Pet. 10. Second, they claim that the Second Circuit, despite its conceded expertise in the securities area (Pet. 13), "distorts beyond recognition the four *Reves* factors and the reasoning that informs them." Pet.10. Neither argument withstands scrutiny:

2. Petitioner's first argument is a classic bootstrap argument, because unless the instruments here at issue are securities, there is no basis for subjecting them to the securities laws, regardless of whether such "loan notes" are plentiful or rare or whether other, concededly applicable laws are adequate or inadequate.[11] It is well-settled, of course, that notes evidencing short-term commercial loans are not securities, *Reves*, 494 U.S. at 65, and prior to this case the courts of appeals were already unanimous in holding that notes evidencing participations in such loans were not securities either. Pet. App. 33a. Thus, the addition of the Second Circuit to the long line of courts holding loan participations exempt from the securities laws does not threaten to create "disorder" in any market (Pet. 11), but simply confirms the "settled expectations of the financial community." Pet. App. 41a-42a; NYCH Br. at 2.

In the instant case, nothing in the straightforward sale of short-term commercial loan notes from Security Pacific to other institutions that provided the funding and assumed the risk served to transform these notes into securities. The participants simply obtained a percentage interest (often 100%) in

11 There is no suggestion that the sale of loan participations, limited as it is to large institutions, has been tainted by fraud (—even petitioners do not claim any fraud here, *see* Pet. App. 42a—), let alone that such large institutions are incapable of protecting themselves through existing state and common law remedies. We also know of no basis for the estimate (referred to in the dissent at Pet. App. 13a) that the short-term "loan note" market exceeds $100 billion. The most recent available Federal Reserve data shows that the total of outstanding loan participations of all kinds is about $50 billion, including the numerous kinds of "traditional" loan participations that petitioners concede are not securities. NYCH Br. 1. Moreover, there is no record support for petitioners' conjectures as to other loan participation programs, or any "large loan note" market. Discovery in this case was limited to Security Pacific's business, and the Second Circuit properly emphasized that its decision concerned the "loan participations as marketed in this case." Pet. App. 23a.

an underlying loan that retained all its essential characteristics. Pet. App. 5a, 8a, 26a. There was no pooling of loans, no alteration of maturity dates, no recourse to anyone but the borrower. Pet. App. 5a, 7a-8a, 23a, 29a, 31a, 34a, 42a. There was no secondary market for, or other trading in, the loan participations, and they could not be subordinated, resold or otherwise transferred without Security Pacific's express written consent, which was virtually never given. Pet. App. 22a, 31a, 36a.[12]

Petitioners are thus reduced to arguing that since Security Pacific's loan participations are sometimes marketed in competition with short-term commercial paper, they should be treated under the securities laws in the same manner as commercial paper, which petitioners label a "recognized 'security'." Pet. i. The argument is full of fallacies:

To begin with, since all forms of short-term commercial debt compete with each other, the logical result of petitioners' argument would be that even ordinary short-term commercial loans would be deemed securities. This Court has held flatly to the contrary. *See Reves*, 494 U.S. at 65.

As this suggests, various forms of short-term debt differ from one another in ways highly relevant to determining whether they constitute "securities." In particular, commercial paper, unlike loan participations, is frequently sold in small denominations, is available to individual investors, is freely negotiable and highly liquid, and is sold by dealers who assume no responsibility for managing repayment of the underlying debt but who stand ready to make a market in the paper sold through them.[13] These are precisely the kinds of attributes that invite application of the securities laws.

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12 *See also* A906-07, A2401-03, A3973. Although Security Pacific agreed to repurchase loan participations on a "best efforts basis," in fact it repurchased less than $^{3}/_{10}$ of 1% of all loan participations sold from June 1, 1988 to June 12, 1989. A635.

13 *See, e.g.*, G. Kaufman, *The U.S. Financial System-Money, Markets and Institutions* 67 (4th ed. 1989); E. Hurley, *The Commercial Paper Market*, 1977 Fed. R. Bull. 525, 529; K. Handal, *The Commercial Paper Market and The Securities Acts*, 39 U. Chi. L. Rev. 362, 362-364, 370 n.51 (1972); Federal Reserve Bank of Richmond, *Instruments Of The*

It should also be noted that short-term commercial paper itself is far from a "classic" security, thus further attenuating the force of the supposed analogy. Indeed, the 1934 Act, which contains the most commonly used antifraud provisions, altogether excludes such paper from the definition of "security," *see* 15 U.S.C. § 78(c)(a)(10), while the 1933 Act exempts it from that Act's most central requirement, registration, *see* 15 U.S.C. § 77c(a)(2). Moreover, while the 1933 Act nominally subjects commercial paper to the coverage of Section 12(2), a great deal of such paper is sold in "private placements" that effectively remove it from such coverage.[14]

Unlike commercial paper, loan participations are fully subject to federal banking laws and regulations, including the disclosure provisions of OCC Circular 181, discussed *infra*. Pet. App. 9a-10a. But there is no guarantee that, if deemed securities, loan participations would qualify for any of the exclusions or exemptions accorded short-term commercial paper. Pet. App. 42a.[15] Thus the dubious result of petitioners' argument-by-analogy would be to subject loan participations to a double regime of duplicative and expensive regulation while leaving commercial paper largely unregulated. Pet. App. 41a-42a.

3. While petitioners complain that the Second Circuit applied the *Reves* factors "superficially and mechanically" (Pet.15), what they really mean is that the court correctly limited its analysis to the facts of this case, rather than addressing the hypothetical horribles conjured up by petitioners. Pet. App. 23a. An examination of the Second Circuit's opinion reveals a

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Money Market 111 (6th ed. 1986); M. Stigum, *The Money Market* 1024, 1051-52 (3d ed. 1990); E. Weiss, *The Courts Have It Right: Securities Act Section 12(2) Applies Only To Public Offerings*, 48 Bus. Law. 1, 25 n.135 (1992).

14 *See* Weiss, *op. cit.*, 48 Bus. Law. 1, 25 n.135 (1992).

15 As the district court noted, this would "portend grave practical consequences." Pet. App. 41a. For example: "Registration requirements under federal laws would all but put an end to the flexibility of every day commercial loans conceived and intended for working capital purposes of a business if they were saddled with SEC requirements by labelling a loan participation therein as a security." Pet. App. 42a.

careful analysis of each of the factors set forth in *Reves* as applied to the actual and undisputed facts of record.

i. The Motivations of the Parties to the Transaction

This first test focuses on the motivations of all the parties to the transaction. While purporting to quote from this Court's recitation of factors bearing on this determination, petitioners elide from their quotation the Court's unqualified statement that a note is less sensibly described as a security if it is exchanged "to correct for the seller's cash-flow difficulties" (*Reves*, 494 U.S. at 66)—precisely the case here. Pet. App. 5a, 9a.[16]

In *Reves*, the Court found that the notes in question were sold to raise capital, that the buyers were induced to purchase by the prospect not of a fixed return but of an "interest rate" that was constantly revised to keep it above the rate paid by banks, and that "from both sides . . . the transaction is most naturally conceived as an investment in a business enterprise. . . ." *Reves*, 494 U.S. at 68. In the instant case, by contrast, the district court found no dispute "that the short-term multi-million dollar loans made by Security Pacific to Integrated were made to facilitate its current operations," *i.e.*, its cash-flow needs, and that the participant's motivation in buying part or all of the loan was to use its excess cash to purchase a vehicle that would earn a fixed short-term return. Pet. App. 36a. The district court therefore concluded that "the overall motivation of the parties was the promotion of commercial purposes and not investment in a business enterprise." Pet. App. 36a. On the basis of its own, independent review of the record, the Court of Appeals concurred. Pet. App. 9a.

Petitioners, although not disagreeing with the lower courts' assessments of the parties' respective motivations, claim that

16 Since petitioners' neglect of this key language was called to their attention in the Court of Appeals (Brief of Defendants Security Pacific National Bank *et ano.* p. 24), their continued elision of this language cannot be attributed to inadvertance.

these are the same motivations that underlie all sales of short-term corporate debt and that the transactions should "therefore" be viewed as investments in "securities." Pet.16. But, as previously noted, this equation of all forms of short-term corporate debt with "securities" is contrary to established precedent. A simple short-term commercial loan is a form of corporate debt in which the seller seeks fixed interest and the buyer seeks to alleviate cash-flow difficulties—and it is well settled that the loan note in such an instance is not a security. *Reves*, 494 U.S. at 65. Likewise, these are the classic motivations also found in the case of a "traditional" loan participation, an instrument whose status as a non-security is conceded even by petitioners. Pet. App. 8a.

Petitioners seek to distinguish these cases by arguing that here Security Pacific functioned not as a lender but as an underwriter because it sought to generate profits while retaining no credit risk for itself. Pet. 4-6, 16. This ignores the fact that Security Pacific extended the participation line-of-credit to Integrated as an adjunct to existing non-participated lines. Pet. App. 5a, 35a.[17] More generally, the district court, after examining the facts of record not genuinely in dispute, concluded that:

> the uncontradicted motivation of the seller, Security Pacific, was to increase lines of credit available to Integrated as part of a continuing credit relationship. The sale of an Integrated loan would permit Security Pacific to diversify its risk among participants. Pet. App. 35a.

Again, the Court of Appeals, after examining the record *de novo* and resolving "all ambiguities and inferences" in favor of petitioners, reached the same conclusion. Pet. App. 7a, 9a.

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17 *See also* A275, A605. Petitioners thus mischaracterize the record in suggesting that participations originate when banks "acquire a large amount of a corporate issuer's short-term, unsecured debt and immediately re-sell" it in "small pieces." Pet. 4-6. In reality, as shown above, Security Pacific did not "acquire" Integrated debt, it made loans to Integrated. Pet. App. 5a, 26a, 29a. Nor did it sell in "small pieces," unless one considers a 100% participation of a $10 million loan a "small piece." Pet. App. 26a, 29a-30a. Eight of the twelve loans here were sold in their entirety. A750-51.

ii. The Plan of Distribution

Under the second *Reves* test, the court is to examine the "plan of distribution" of Security Pacific's loan participations to determine whether it is an instrument in which there is "common trading for speculation or investment." *Reves*, 494 U.S. at 66.

In *Reves*, the Court found that the agricultural co-operative offered its notes "in a large scale offering to unsophisticated members of the public," and sold to over 1,600 such persons. *Id.* at 71. Thus, the Court concluded that these notes were "offered and sold to a broad segment of the public, and that is all that we have held to be necessary to establish the requisite common trading." *Id.* at 68.

In contrast, the Integrated loan participations sold by Security Pacific were sold in " 'a limited solicitation to sophisticated financial or commercial institutions and not to the general public.' " Pet. App. 9a, 36a. Indeed, these participations could not be traded or resold without the express written permission of Security Pacific, which further insured that these participations could not be sold to the general public. Pet. App. 22a.

Petitioners' response that an instrument need not be traded on an exchange to be a security misses the point. Pet. 18.[18] All of the cases cited by petitioners in support of this proposition were cases in which, unlike here, instruments were offered to

18 Likewise irrelevant is petitioners' argument that the securities laws protect sophisticated investors as fully as unsophisticated ones. Pet. 12. Once the securities laws are found to apply to the purchase of a particular instrument, they apply to all purchasers regardless of sophistication. But that does not mean that the financial sophistication of the persons who ordinarily purchase a particular kind of instrument is irrelevant to determining whether to extend the coverage of the securities laws to that instrument in the first place. On the contrary, both the caselaw and the legislative history suggest that such a fact is highly relevant. *See Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1132 (2d Cir. 1976); E. Weiss, *op-cit.*, 48 Bus. Law. 1, 17 (1992); J. Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 37 (1959).

the general public. *See Reves*, 494 U.S. at 68, 71; *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 683 (1985) (stock of a lumber business offered to the public through brokers in several states); *Tcherepnin v. Knight*, 389 U.S. 332, 333 n.2 (1967) (shares of a savings association sold to over 5,000 members of the public through printed mailed solicitations). Since, by contrast, Security Pacific's loan participations were unavailable to the public and could not be freely negotiated or traded (Pet. App. 22a, 36a), the Second Circuit was clearly correct in concluding that these were not instruments in which there is "common trading for speculation or investment," and that, under this test, loan participations are not securities.[19]

iii. The Reasonable Expectations of the Investing Public

As both the district court and court of appeals found, the banks and sophisticated institutions that actually purchased these interests "were given ample notice that the instruments were participations in loans and not investments in a business enterprise." Pet. App. 9a, 37a. Among other things: (1) each and every document provided to the purchasers emphasized that what was for sale was a "loan participation" (Pet. App. 27a); (2) Security Pacific announced to its prospective pur-

19 Petitioners contend that the Second Circuit's opinion is at odds with prior decisions deeming short-term corporate debt to be "securities." However, in virtually all of the cited cases, solicitations were made to the general public to make an investment. The securities purchased in those cases are not affected by the court's limited decision here. *See, e.g., SEC v. American Bd. of Trade, Inc.*, 751 F.2d 529, 531 (2d Cir. 1984) (commercial paper sold via public offering to small investors), *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 492 (7th Cir. 1984) (seller made a "broad solicitation of members of the general public"); *Lawler v. Gilliam*, 569 F.2d 1283, 1286 (4th Cir. 1978) (over 100 individual investors offered notes promising investment returns of 30% to 100%); *SEC v. World Radio Mission, Inc.*, 544 F.2d 535, 538 (1st Cir. 1976) (general public solicited to invest in notes issued by a religious organization); *Zeller v. Bogue Electric Mfg. Corp.*, 476 F.2d 795, 799 (2d Cir.), *cert. denied*, 414 U.S. 908 (1973) (commercial paper not exempted from the 1933 Securities Act unless of a type "not ordinarily purchased by the general public.").

chasers that these instruments were not "securities" and repeated this to any purchaser who inquired (A581, A1025-26, A1924); (3) the courts had uniformly held that loan participations were not "securities" (Pet. App. 33a); (4) many of the petitioners characterized their purchases of loan participations as "loans" in their own internal records made at the time of purchase, while none characterized them as "securities" (A939d, A948, A954, A2439-41, A3028); (5) no purchaser ever claimed coverage of the securities laws until after Integrated's default; and (6) the MPA, executed by each petitioner as the contract governing its purchases of loan participations, disclaimed the very obligations that would exist if securities were being purchased. Pet. App. 5a. Based on these and other undisputed facts, the district court appropriately found "[a]n industry-wide traditional understanding which negates the application of federal securities laws to commercial participations in short-term bank loans." Pet. App. 42a.

In response, petitioners emphasize the occasional language in a few of Security Pacific's brochures referring to loan notes as "investments" that compare favorably to "commercial paper." Pet. 19.[20] But, as noted earlier, simply because loan participations in some sense compete with commercial paper, and with other debt instruments, affords of itself no reasonable basis for inferring that both are securities or otherwise legally identical. As for the protean terms "investment" and "investor," in no fair reading can their use in these brochures be read as denoting some technical legal meaning or distinction, as opposed to their more common use as the equivalent of "purchase" and "purchaser."[21]

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20 Petitioners' additional emphasis on the fact that part of Security Pacific's program utilized space in a room that also housed the operations of its transactions of government instruments, foreign currencies and Eurodollar futures (Pet. 5) is misplaced since this fact was unknown to purchasers and cannot possibly shed light on their "expectation."

21 As the Second Circuit has noted, "[i]n one sense every lender of money is an investor since he places his money at risk in anticipation of a profit in the form of interest." *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1135 (2d Cir. 1976).

iv. The Existence of Another Regulatory Scheme or Other Risk Reducing Factor Making Application of the Securities Laws Unnecessary

This last *Reves* test is reached only if, under the first three tests, an instrument is likely to be a security. Since under the first three tests, loan participations are not securities, the Second Circuit need not have addressed this issue. Nevertheless, both the Second Circuit and the District Court correctly found that the Office of the Comptroller of the Currency ("OCC") had issued specific policy guidelines addressing the sale of loan participations and that the existence of this regulatory scheme made application of the securities laws unnecessary. Pet. App. 9a-10a, 37a. Indeed, OCC Circular 181, as well as the banking regulators' general authority to prevent "unsafe and unsound practices," the availability of state and common law remedies, and the limitation of the relevant market to large and sophisticated institutional purchasers able to fend for themselves, have combined to keep loan participation programs free of fraud, as well as an extremely efficient mechanism for enhancing much needed commercial credit. NYCH Br. 2-3, 9-10.

Petitioners, however, while alleging no claim of fraud in this case, nonetheless contend that the existing banking regulatory scheme is insufficient because, they allege, OCC Circular 181 imposes no restrictions on selling banks but applies only to national bank purchasers, a group that comprises only 15% of Security Pacific's customers. Pet. 20. As summarized by the OCC, however, Circular 181 requires that "[t]he selling bank must provide complete and current credit information . . . [including] any information on the borrower's continuing credit worthiness." Pet. App. 49a. Further, the circular requires "[d]isclosure by the selling bank of complete and regularly updated credit information on the obligor during the term of the loan." Pet. App. 48a. Finally, Circular 181 requires selling banks to apply the same standards of credit review to these transactions as the bank applies to all its loans, and warns that "the sale . . . of a low quality loan may be considered an

unsafe and unsound banking practice by the OCC." Pet. App. 49a.[22] These requirements, and plenary bank regulation in general, are more than sufficient to significantly reduce any risk of fraud attendant to a loan participation sale. Pet. App. 9a-10a.

In sum, the Court of Appeals faithfully applied the four-factor test of *Reves* to the specific and undisputed facts of this case.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Dated: December 24, 1992

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22 Moreover, even if petitioners' interpretation of Circular 181 were correct, since national bank purchasers constitute a sizeable percentage of Security Pacific's loan participations Security Pacific, to protect itself, would have to adhere to the requirements of Circular 181 in selling its loan participations.